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Non-performing Loans – Different this Time?

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NPLs

- Previous research suggests that pre-crisis NPLs are not a good indicator of future NPL problems and that macro and banking conditions help predict future NPL problems.
- I present the outcomes of an empirical model for NPLs for a very large sample of banks in countries in the euro area over the period 1995-2019.
- This is complemented with a case study about situation of Dutch firms.

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Our model (1)

- Literature has identified the level of economic activity and interest rates as the most relevant macro-economic drivers of NPLs.
- We focus on a few bank-specific variables for two reasons. First, for some frequently used variables causality is likely to run from NPLs to these variables. Second, the literature provides very mixed support for several other bank-specific variables. Our selection of bank-specific variables is based on the support previous studies report for their inclusion.

Our model (2)

- We include: (1) loans: bank trying to increase its market share is likely to reduce its minimum credit standard, which increases the chances of loan defaults by borrowers. We measure loans by the loans-to-assets ratio. (2) bank capitalisation: managers in banks with low capital bases face a moral hazard incentive to engage in high-profitability but high-risk lending. We measure capitalization by the ratio of total equity capital to total assets. (3) loan-to-deposits (LTD) ratio. We measure LTD as banks' deposits to total liabilities.

Our model (3)

- We employ data from Fitch for banks located in the euro area at the consolidated level for the period 1995-2019. All banks for which Fitch provides sufficient data have been included in our analysis.
- In total, we have almost 19,000 observations.

Results (1)

- Macro-economic factors (GDP growth and the unemployment rate) are important and robust drivers of the NPL-ratio. After GFC crisis dummy is significantly negative; interest rate hardly significant.
- Bank-specific factors that are significant: LTA and equity (but only weakly).
- The full model only explains a small part of the variation of NPLs of the banks in euro area countries. This suggests that other factors play a role.

Results (2)

- That is why the position paper offers a case study of NPLs of banks in the Netherlands. This analysis suggests that government guarantees will only shield a very small portion of bank loans. Furthermore, tax deferrals, one of the policy measures that the government took to combat the economic consequences of the pandemic, may, eventually, affect NPLs. In January 2021, tax deferrals in the Netherlands amounted to almost EUR 13 billion.

Results (3)

- Finally, Dutch banks have issued payment deferrals (also known as moratoria), which temporarily allow customers not to pay interest and/or repayments on their loan. Banks expect for 29% of the customers' higher credit losses in the future. This suggests that even if the recovery proceeds as forecasted by the Commission, the NPL ratio may still rise.

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Thank you for your attention